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UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

RICHARD WOOL, et al.,

Plaintiffs,

v.

MICHAEL SITRICK, et al.,

Defendants.

SITRICK AND COMPANY, INC., et al.,

Nominal Defendants.

Case No. CV10-02741 JHN (PJWx)

SITRICK DEFENDANTS' REPLY MEMORANDUM IN SUPPORT OF MOTION FOR RECONSIDERATION OF AUGUST 10, 2010 ORDER

Date: October 4, 2010
Time: 2:00 p.m.
Ctrm: 790
Judge: Hon. Jacqueline H. Nguyen

In their opening brief, the Sitrick Defendants identified several fundamental defects in the First Amended Complaint ("FAC") that were not considered in the Court's August 10, 2010 Order. Acknowledging those defects, plaintiffs assert that their Second Amended Complaint ("SAC"), filed on September 14, 2010, "materially change[s] the allegations against the Sitrick Defendants." (Plfs.' Opp. at 2.) Plaintiffs contend that their revised allegations "address each of the concerns raised in the Motion for Reconsideration," and that if the Sitrick Defendants disagree, "the proper course of action is to file a motion to dismiss with respect to the SAC." (*Id.* at 2, 3.)

While the Sitrick Defendants disagree that the SAC cures the deficiencies that warrant reconsideration, the SAC is not currently before the Court. As discussed below and in the opening brief, the Court should grant reconsideration and dismiss the FAC in its entirety. If the Court denies reconsideration, the Sitrick Defendants reserve the right to address the SAC's deficiencies in a new motion to dismiss.

I. MR. AND MS. SITRICK WERE NOT ERISA FIDUCIARIES WITH RESPECT TO THE REPURCHASE TRANSACTION.

Plaintiffs do not dispute that the December 23, 2008 Redemption Agreement between Reliance and SCI establishes that Reliance was the successor trustee to Mr. Sitrick during the period when the Repurchase Transaction was considered and approved. Nor do plaintiffs dispute that Reliance was the sole entity to review the terms of the transaction on behalf of the ESOP and to approve the transaction on behalf of the ESOP. These undisputed facts conclusively establish that Mr. and Ms. Sitrick did not exercise discretionary authority or control with respect to the Repurchase Transaction. *See, e.g., Pegram v. Herdrich*, 530 U.S. 211, 226 (2000);

Hecker v. Deere & Co., 556 F.3d 575, 583 (7th Cir. 2009).[1]

Plaintiffs advance two arguments regarding Mr. and Ms. Sitrick's purported fiduciary status. First, plaintiffs argue that, as SCI directors who appointed Reliance to serve as the ESOP's independent fiduciary with respect to the Repurchase Transaction, the Sitricks were subject to fiduciary duties in selecting Reliance and monitoring its performance. (Plfs.' Opp. at 4.) This theory of fiduciary liability was not alleged in the FAC and thus cannot salvage the FAC's fiduciary duty claims.

Second, relying exclusively on *Keach v. U.S. Trust Co.*, 234 F. Supp. 2d 872 (C.D. Ill. 2002), plaintiffs argue that Mr. Sitrick may be deemed a *de facto* ERISA fiduciary with respect to the Repurchase Transaction despite the fact that Reliance alone made the decision to approve the transaction. (Plfs.' Opp. at 4.) *Keach* does not support that position. *Keach* involved a group of company directors who appointed US Trust to approve a sale of company stock by the directors to the ESOP. The court held that the directors exercised *de facto* control over the transaction because US Trust had been appointed for "the sole purpose of effectuating the stock purchase transaction," the directors admitted that the decision to go through with the transaction had been made before the appointment of US Trust, and the directors retained authority "to make changes and alterations to the transaction as they deemed necessary." 234 F. Supp. 2d at 882-83.

In stark contrast, it is undisputed here that the decision whether to proceed with the Repurchase Transaction (and on what terms) was made solely by Reliance. (*See* RJN Ex. B (Dkt. No. 32-4) at 1-3.) Mr. Sitrick had no control whatsoever over Reliance's decision, and thus had no *de facto* fiduciary authority over that decision. To the contrary, the Opposition acknowledges that Mr. Sitrick was ESOP trustee

[1] The Opposition has the audacity to argue, with no reference to the FAC, that maybe the FAC is wrong in having pled that Reliance hired the valuation company. (Plfs.' Opp. at 6 n.2.) But that is exactly what the FAC pled. (FAC ¶ 46.)

"until the Repurchase Transaction." (Plfs.' Opp. at 6.) The FAC does not contain a single well pled allegation that Mr. Sitrick continued to act as trustee at the time of the repurchase.[2]

II. THE AUGUST 10 ORDER PUTS MR. AND MS. SITRICK IN AN UNTENABLE POSITION.

As shown in the Sitrick Defendants' opening brief: (1) where an independent fiduciary is appointed, the appointing fiduciary is relieved of any fiduciary duties as a matter of law; and (2) the duty to monitor theory asserted pursuant to *Howard v. Shay*, 100 F.3d 1484 (9th Cir. 1996), is wholly inapplicable where, as here, the expert is not hired directly by a conflicted ERISA fiduciary. Plaintiffs' Opposition does not address, much less dispute, either point. Instead, they resort to repeating arguments related to other issues, divining new facts that are not pled in their FAC,[3] and mischaracterizing and calling into question the allegations of their own pleading.

Plaintiffs do not and cannot refute that the appointment of Reliance as an independent fiduciary relieved the Sitrick Defendants of any fiduciary duties they may have had as a matter of law. 29 CFR 2509.75-8, FR-14. The Motion for Reconsideration should be granted for this reason alone.

Likewise, plaintiffs do not disagree that *Howard* only applies where the conflicted ERISA fiduciary ***directly*** hires the expert. Instead, plaintiffs take issue

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[2] Plaintiffs argue that paragraphs 19 and 67 of the FAC "established" that the Sitricks were ESOP fiduciaries during the Repurchase Transaction. (Plfs.' Opp. at 3.) Plaintiffs are wrong. Paragraph 19 of the FAC pleads nothing more than the fact that Mr. Sitrick was a trustee when the ESOP was formed in 1999. Paragraph 67 pleads nothing more than an unsupported legal conclusion.

[3] Plaintiffs' argument concerning the alleged fiduciary status of the Sitrick Defendants through their status as directors (Plfs.' Opp. at 4) is refuted in Section I, above. Plaintiffs also argue that Mr. Sitrick was the "sole source and filter of information necessary for Reliance and ***its*** appraiser. . ." (*Id*. at 7.) This allegation does not appear in the FAC and hence cannot be considered for purposes of the instant Motion.

with the FAC, calling into question their own allegations that Reliance, an independent fiduciary, was hired "to consider and approve the sale of all of the ESOP's Class B shares in SCI to the Sitrick Trust *and to engage an unknown financial advisor* to prepare a valuation and/or fairness opinion to support the Transaction." (FAC ¶46; emphasis added.) Moreover, Paragraphs 48, 50, 51, 54, 69(i), 71(a) and 71(b) of the FAC all refer to "Reliance and ***its*** financial advisor." Even plaintiffs' Opposition makes the same concession. (Plfs.' Opp. at 7.)

Remarkably, plaintiffs now claim that they do not know whether the allegations in their FAC are even true. (Plfs.' Opp. at 6 n.2.) Plaintiffs, however, cannot disavow their own allegations as is convenient. The FAC clearly and repeatedly states that Reliance, acting as successor trustee and independent fiduciary, hired the valuation company, and for purposes of this Motion, these allegations must be taken to be true. Accordingly, *Howard* is inapplicable to this case and the Sitrick Defendants' Motion should be granted.

III. THE FAC FAILED TO STATE A CLAIM AGAINST THE SITRICK DEFENDANTS AS PARTIES IN INTEREST.

In their opening brief, the Sitrick Defendants showed that the dollar amount of the consideration approved by Reliance, relative to the ESOP's original 1999 valuation and an alleged offer by Resources in 2007 or 2008, is insufficient by itself to establish that the ESOP did not receive adequate consideration pursuant to the Repurchase Transaction. Plaintiffs do not dispute that point. Instead, plaintiffs argue that the Court cannot reach this issue on a motion to dismiss. (Plfs.' Opp. at 7-9.) Courts have regularly held otherwise, however, finding that statutory defenses to prohibited transaction claims under ERISA may be applied at the pleading stage. *See, e.g., In re Honeywell Int'l ERISA Litig*., No. Civ. 03-1214, 2004 WL 3245931, at *13-*14 (D.N.J. Sept. 14, 2004). Confirming this principle, the August 10 Order addressed the sufficiency of the FAC's allegations that the ESOP did not receive adequate consideration. (Aug. 10 Order at 16-17.)

Plaintiffs also argue that *Harris Trust and Savings Bank v. Salomon Smith* Barney, 530 U.S. 238 (2000), does not apply, asserting that "[n]othing in that decision establishes a pleading standard which requires detailed facts to prove a state of mind." (Plfs.' Opp. at 9.) To the contrary, *Harris Trust* holds that party in interest liability requires "actual or constructive knowledge of the circumstances that rendered the transaction unlawful." *Id*. at 251. Knowledge of the transaction's unlawfulness—in this case, knowledge that the transaction was not exempt under Section 408(e)'s adequate consideration exemption—is thus an essential element of plaintiffs' claim and must be adequately alleged in the complaint. *See, e.g.*, *Bautista v. Los Angeles County*, 216 F.3d 837, 840 (9th Cir. 2000). The FAC failed to allege this essential element with the factual support required under *Ashcroft v. Iqbal*, 129 S. Ct. 1937 (2009). *See id*. at 1949 ("a formulaic recitation of the elements of a cause of action will not do"). The Sitrick Defendants' Motion should therefore be granted.

CONCLUSION

For the reasons set forth above, the Sitrick Defendants respectfully request that the Court reconsider the portion of its August 10 Order denying dismissal of plaintiffs' claims based on the Stock Repurchase Transaction, and enter a new order dismissing the FAC in its entirety.

Dated: September 20, 2010

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